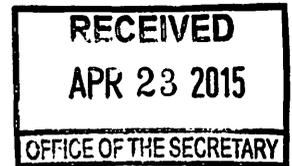


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**UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION**



**ADMINISTRATIVE PROCEEDING
File No. 3-16353**

In the Matter of

**Spring Hill Capital Markets, LLC,
Spring Hill Capital Partners, LLC,
Spring Hill Capital Holdings, LLC,
and Kevin D. White,**

Respondents.

EXPERT REPORT BY YUI M. CHAN

The Division of Enforcement ("Division") respectfully submits the enclosed expert report by Yui M. Chan, Managing Director of the Broker-Dealer Operations and Financial Responsibility Department in the Risk Oversight & Operational Regulation Division of FINRA.

Dated: April 20, 2015
New York, New York

DIVISION OF ENFORCEMENT

By: /s/ Nicholas Pilgrim
Nicholas Pilgrim
Daniel Loss
Securities and Exchange Commission
New York Regional Office
Brookfield Place, 200 Vesey Street, Suite 400
New York, New York 10281

April 20, 2015

**EXPERT REPORT CONCERNING IMPACT OF
SPRING HILL CAPITAL MARKETS, LLC'S PURCHASE
OF GRAMERCY CDO BOND ON FIRM'S NET CAPITAL**

by

Yui M. Chan

I. MY QUALIFICATIONS

My experience as an expert is set forth in my Curriculum Vitae attached as Appendix A.

II. PURPOSE OF THIS REPORT

The Division of Enforcement has asked me to analyze the impact on the net capital of Spring Hill Capital Markets, LLC ("SHCM" or the "Firm") of the Firm's purchase from Barclays of a bond identified as GKKRE 2005-1A A1, CUSIP No. 385000AA2, a collateralized debt obligation known as Gramercy Real Estate CDO 2005-1 (the "Gramercy CDO bond").¹

III. FACTUAL BACKGROUND

SHCM has been registered with FINRA and the Commission as a broker-dealer since February 26, 2010.²

On March 12, 2010, a trader at SHCM (Paul Tedeschi) contacted a registered representative at Barclays (Kevin Carney) to seek to purchase \$15 million face amount of the Gramercy CDO bond at a price of \$70.75.³ According to Mr. Tedeschi, he and Mr. Carney, on behalf of their respective firms, reached an agreement in principle on the terms of the trade, including the price, by March 15, 2010.⁴ On the following day at 15:23:30 UTC (i.e., 11:23:30

¹ See Offering Memorandum dated July 8, 2005 (SHC-000004249).

² See FINRA BrokerCheck Report, Spring Hill Capital Markets, LLC, CRD #150898.

³ Investigative Testimony Ex. 26; Tedeschi Investigative Testimony Tr. 108:2 – 109:5.

⁴ Investigative Testimony Ex. 53; Tedeschi Investigative Testimony Tr. 117:17-119:18 ("Yes, there was an agreement in principle of the terms of the trade, yes.")

AM EDT),⁵ Mr. Tedeschi and Mr. Carney entered a Bloomberg chatroom.⁶ Pursuant to the ensuing exchange between 11:24 AM and 11:36 AM EDT, the two firms confirmed their agreement for SHCM to purchase \$15 million face amount of the Gramercy CDO bond from Barclays at a price of \$70.75.⁷ At 15:36:04 UTC (i.e., 11:36 AM EDT) on March 16, Mr. Carney wrote, “ok, that’s done, thanks for the trade.”⁸ Also at 11:36 AM, Mr. Carney sent Mr. Tedeschi a trade ticket evidencing SHCM’s purchase of the bond from Barclays. Prior to this transaction, SHCM had net capital of between approximately \$200,000 and \$395,508.⁹

Later on March 16, Kevin White, the CEO of SHCM, communicated with Roger Cozzi of Gramercy Capital Corp. (“GCC”) regarding terms for a sale of the Gramercy CDO bond to GCC. At 6:17 PM, Mr. White relayed the outcome of his negotiations to Mr. Tedeschi, stating, “Done @ \$74. Nice trade!”¹⁰ Approximately fifteen minutes later, Patrick Quinn, a registered representative at SHCM, contacted the firm to which it introduced trades – Rafferty Capital Markets, LLC (“Rafferty”) – to explain that SHCM was “likely to have a trade with [GCC] tomorrow.”¹¹ At 1:49 PM the next day (March 17), Mr. Quinn passed a trade ticket containing the transaction terms to GCC. The trade ticket noted, “SPRING HILL SELLS TO GRAMERCY.”¹² One minute later, at 1:50 PM, Mr. Quinn forwarded the tickets for the both transactions – *i.e.*, the purchase of the Gramercy CDO bond from Barclays and the subsequent

⁵ I understand that UTC is an abbreviation for Coordinated Universal Time, which is 4 hours later than Eastern Daylight Time.

⁶ Investigative Testimony Ex. 54.

⁷ Investigative Testimony Ex. 54.

⁸ Investigative Testimony Ex. 54.

⁹ See Focus Report as of 2/26/10; Focus Report as of 3/31/10.

¹⁰ Investigative Testimony Ex. 55.

¹¹ SHC-000017494.

¹² SHC-000018249.

sale of the bond to GCC – to Rafferty. Mr. Quinn told Rafferty that GCC would know March 17 as the trade date.¹³

IV. OPINION

A. The Transactions at Issue

In my opinion, the risks and rewards associated with the Gramercy CDO bond transferred from Barclays to SHCM no later than 11:36 AM EDT on March 16, when Mr. Carney wrote, “ok, that’s done, thanks for the trade,” and passed a trade ticket reflecting the transaction terms to Mr. Tedeschi. On the other hand, the earliest indication that the risks and rewards associated with the Gramercy CDO bond may have transferred from SHCM to GCC is Mr. White’s 6:17 PM EDT email to Mr. Tedeschi stating, “Done at \$74.” Alternatively, there is evidence suggesting that SHCM’s sale to GCC actually occurred on March 17, which Mr. Quinn said GCC would know as the trade date. However, irrespective of whether the sale to GCC took place on the evening of March 16 or the following afternoon, on March 17, SHCM was beneficial owner of the Gramercy CDO bond for at least several hours following its transaction with Barclays.

B. The Impact of the Gramercy CDO Bond Purchase on SHCM’s Net Capital

For purposes of my analysis, I have elected to apply the assumptions most favorable to SHCM. Specifically, I assume (1) that SHCM did not assume ownership of the Gramercy CDO bond until March 16, 2010 at 11:36 AM; and (2) that SHCM transferred ownership of the bond to GCC at 6:17 PM on March 16. As set forth below, even under these assumptions, SHCM’s purchase of the Gramercy CDO bond resulted in a net capital deficiency.

¹³ SHC-000018260.

Because SHCM used a trade date basis of recordkeeping,¹⁴ the trade date must also be used when assessing SHCM's net capital. Accordingly, as of SHCM's trade with Barclays, its assets and liabilities increased by the approximately \$10.6 million cost of the trade (*i.e.*, \$15 million face x \$70.75). In computing net capital, a broker-dealer must take prescribed percentage deductions known as "haircuts" from the value of proprietary positions.

The Gramercy CDO bond, which met the requirements of paragraph (F) of SEA Rule 15c3-1(c)(2)(vi), would require a haircut of 9% (based on 25 years remaining to maturity of the bond in March 2010, with a maturity date of July 2035) and the transaction with Barclays would reduce SHCM's net capital by approximately \$954,000 (*i.e.*, \$10.6 million x 9% haircut). As a result, SHCM became net capital deficient in an amount exceeding \$500,000 and remained out of compliance with the Net Capital Rule until it sold the Gramercy CDO bond to GCC between several hours and more than one day later.

As SHCM was a broker-dealer registered with the Commission at the time of its purchase of the Gramercy CDO bond from Barclays, the Firm and Kevin White, as the firm's Chief Executive Officer and a Series 24 General Securities Principal, was expected to understand the impact of the transaction on the Firm's compliance with the Net Capital Rule. Compliance with the Net Capital Rule is an on-going obligation. This requirement is addressed in an interpretation of the Net Capital Rule provided to the New York Stock Exchange in 1999 by SEC staff, which has been included in the *Interpretations of Financial and Operational Rules (GTRI)* since 1999 and published on the FINRA website (www.finra.org) since 2008. The interpretation, entitled *Moment to Moment Net Capital*, states the following:

Broker-dealers must maintain sufficient net capital at all times prior to, during and after purchasing or selling proprietary securities. Broker-dealers must have at all times (including intraday)

¹⁴ See Spring Hill Capital Markets, LLC SEC Form X-17A-5 for period ending 12/31/10.

sufficient net capital to meet the haircut requirements of the Capital Rule before taking on any new proprietary positions, even if the intention of the firm is to liquidate or cover the positions before the end of the same day. Broker-dealers are expected to be able to demonstrate moment to moment compliance with the Capital Rule.

(SEC Staff to NYSE) (No. 99-8, August 1999)

SEC staff interpretations, whether provided to the NYSE, FINRA, or previously to NASD, are applicable to any broker-dealer subject to the Net Capital Rule. The above interpretation makes clear that a firm may not take on intra-day risk, in contravention of the Net Capital Rule, simply because it believes it will be flat the securities position at the end of the day. Citing the interpretation, a Notice to Members published on the NASD or FINRA websites since 2007 contains the following “Q&A”:

- Q. Are members required to maintain an appropriate amount of net capital only as of the close of each business day?
- A. No. SEC Rule 15c3-1(a), which governs net capital requirements, requires a broker or dealer to maintain its required net capital continuously. Broker-dealers must be able to demonstrate moment-to-moment compliance with SEC Rule 15c3-1¹⁵

Irrespective of any communications between SHCM and GCC about a likely or probable transaction between them, such communications do not substitute for an actual sale, which I believe did not occur in the case of the Gramercy CDO bond until approximately 6:17 PM on March 16, 2010 at the earliest.

Finally, it is my understanding from the trade tickets that the purchase of the Gramercy CDO bond from Barclays and the sale to GCC had a common settlement date. That fact does not change my view with respect to the net capital violation. The AICPA Audit and Accounting Guide *Brokers and Dealers in Securities* (2012 Edition) describes trade date as follows: “The date on which an agreement (an executory contract) is entered into, setting forth the important

¹⁵ NASD, “Notice to Members,” April 2007, available at <http://www.finra.org/sites/default/files/NoticeDocument/p018897.pdf>.

aspects of the transaction (such as a description of the instruments, quantity, price, delivery terms, and so forth).” [Section 7.56]. It goes on to say: “Although the terms for each type of transaction may differ in many respects, they tend to have the following two major aspects in common: a. On the trade date, the purchaser assumes the risks and rewards of further changes in the value of the underlying financial instrument. b. On the settlement date, the seller is required to deliver and the purchaser is required to pay for, the financial instrument.” [Section 7.58]

Further, as noted in a letter from the staff of the SEC’s Division of Market Regulation to the American Institute of Certified Public Accountants (AICPA) dated April 23, 1986:

Broker-dealers that use the trade date basis of record keeping are in compliance with the AICPA Guide for Audits of Brokers and Dealers in Securities while broker-dealers that use the settlement date basis of recordkeeping are in compliance with the Guide only if the difference between trade date and settlement date accounting is not material.

A broker-dealer must have a consistent policy of reflecting all transactions either on a trade date or a settlement date basis and must compute its net capital on the same basis as it uses in recording its transactions. However, if settlement date accounting is used, and there is a “material difference” between trade date accounting, the net capital computation must reflect the trade date position for proprietary positions. . . .”¹⁶

This letter is in the public domain, and the passage referenced above is contained verbatim in the Interpretations of Financial and Operational Rules (GTRI) published on FINRA’s website. In short, because SHCM reflected transactions on a trade date basis in its records, it was required to compute its net capital on the same basis.

V. CONCLUSION

As a result of SHCM’s purchase of the Gramercy CDO bond from Barclays, the Firm failed to maintain the level of net capital required pursuant to the Net Capital Rule for between several hours and more than one day. As SHCM was a broker-dealer registered with the Commission at the time of the transaction, SHCM and Kevin White, for the reasons described

¹⁶ Letter from Michael Macchiaroli, Assistant Director, Division of Market Regulation, to AICPA, 1986 No-Act. LEXIS 2375, at *4-5 (Apr. 23, 1986).

above, were expected to understand that purchasing the Gramercy CDO bond from Barclays would have resulted in the application of haircuts, and in the case of SHCM, a violation of the Net Capital Rule.

APPENDIX A
CURRICULUM VITAE

Yui M. Chan

(646) 315-8426 (Work)

Yui.chan@finra.org

Employment:

Financial Industry Regulatory Authority, New York, New York

Managing Director – Broker-Dealer Operations and Financial Responsibility Department (2007 – present)

Main responsibilities include the following:

- Manage staff which liaison with the Securities and Exchange Commission's Division of Trading and Markets for administering interpretive guidance of the SEC's broker-dealer Net Capital (15c3-1), Customer Protection (15c3-3) and Record Keeping (17a-3, 17a-4 and 17a-5) rules. In addition, provide interpretive guidance to the FINRA financial responsibilities rules.
- Provide in-depth clarification, technical guidance and education to the FINRA staff, the SEC, other SROs, member firms and industry organizations in resolving financial and operational regulatory issues, reviewing firm proposals and addressing industry initiatives.
- Participate as FINRA representative on Industry Committees, Task Force, Working Groups and FINRA Committees to discuss and provide regulatory insight and technical guidance on financial and operational regulatory issues and industry initiatives, such as representing FINRA on the SIFMA Regulatory Capital & Margin Committee, as well as serving on the FINRA Series 27/28 Fin-Op Principal Qualification Exam Review Committee.
- Participate in meetings with FINRA Staff, the SEC and industry groups to discuss interpretive issues, rule-making initiatives as well as to provide updates on significant financial and operational regulatory developments and concerns.
- Draft and issue interpretations to the SEC's broker-dealer Net Capital, Customer Protection and Record Keeping rules for inclusion into the FINRA SEC Rule Interpretation Handbook. Draft and issue FINRA Regulatory Notices on regulatory guidance related to financial and operational matters.

New York Stock Exchange Regulations, New York, New York

Managing Director/Director – Broker-Dealer Operations and Financial Responsibility Department (2001 – 2007)

See employment description above under *Financial Industry Regulatory Authority*.

Principal Examiner/Supervising Senior Examiner (1993 – 2001)

Additional duties and responsibilities included the following: serving as supervisor or lead examiner on examinations of medium to large size member firms which carry and clear customer accounts; supervising, training and developing new and lesser experienced examiners; and reviewing completed examination work-papers and reports.

Senior Examiner/Examiner/Examiner Trainee (1988 – 1993)

Started in 1988 as a trainee in the NYSE Examiner Training Program and progressed through the ranks until attaining the level of Senior Examiner in 1993. Main responsibilities included the following: participating in the examination of NYSE member firms for financial, operational and sales practice compliance with NYSE, SEC, CFTC, and FRB rules and regulations; identifying and evaluating material risks and critical areas of regulatory concern of member firms; identifying and evaluating risk associated with financial investments offered and carried by member firms; conducting meetings and interfacing with senior management of member firms on corrective actions necessary to ensure compliance with rules and regulations and minimize risk exposure; and preparing reports of examination results to member firms and NYSE staff.

Regulatory Publications (FINRA):

2014: FINRA Regulatory Notice: 14-06, 14-12, 14-25 and 14-38

2013: FINRA Regulatory Notice: 13-41 and 13-44

2012: FINRA Regulatory Notice: 12-54 and 12-58

2011: FINRA Regulatory Notice: 11-38

2010: FINRA Regulatory Notice: 10-03, 10-12 and 10-46

2009: FINRA Regulatory Notice: 09-38

2008: FINRA Regulatory Notice: 08-38, 08-56, 08-60 and 08-65

2007: FINRA Regulatory Notice: 07-58 and 07-60

Regulatory Publications (NYSE):

2007: NYSE Interpretation Memo: 07-1, 07-2, and 07-4

2006: NYSE Interpretation Memo: 06-1, 06-3, 06-4 and 06-5

2005: NYSE Interpretation Memo: 05-1, 05-2 and 05-8

Education:

New York University – Leonard N. Stern School of Business

Bachelor of Science, 1988

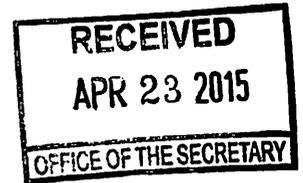
Majors: Finance and International Business

Other Concentrations: Economics and Sociology



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April 20, 2015

Via UPS

Brent J. Fields, Secretary
Office of the Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: *In re Spring Hill Capital Markets, LLC, et al.*, AP File No. 3-16353

Dear Mr. Fields,

Enclosed please find copies of the Division's amended exhibit list and the expert report submitted by the Division's expert, Yui M. Chan.

Respectfully submitted,

Daniel Loss
Counsel

cc: The Honorable Carol Fox Foelak (via email)

Ronald W. Dunbar, Jr., Esq. (via email)
Andrew E. Goloboy, Esq. (via email)
Counsel for Respondents